

***United States Court of Appeals  
for the Second Circuit***



**BRIEF FOR  
APPELLEE**



# 76-5001

To be argued by  
GARY J. COHAN

In The  
**United States Court of Appeals**  
For The Second Circuit

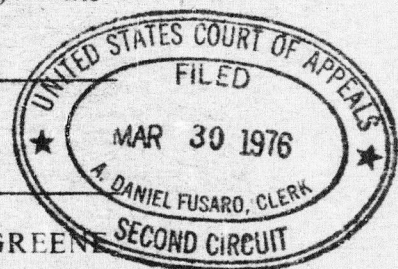
IN THE MATTER OF  
MEDICAL ANALYTICS,

Debtor.

On Appeal from the United States District Court for the  
Southern District of New York

## BRIEF FOR APPELLEE

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QUESTION PRESENTED

Did the Bankruptcy Court and the District Court correctly hold that the Bankruptcy Court's jurisdiction, pursuant to 11 U.S.C. §786, to set aside a confirmation of a plan of arrangement is expressly limited to consideration of petitions filed within six months of confirmation that allege fraud in procuring the arrangement discovered by petitioner subsequent to confirmation?

### STATEMENT OF THE CASE

This is an appeal from an order of the United States District Court for the Southern District of New York (Conner, J.), affirming a decision of the Bankruptcy Court (Ryan, J.), entered May 16, 1975, granting the motion of MetPath Inc. ("MetPath") for an order dismissing the petition of appellant Medical Analytics, Inc. ("Medical") to set aside a confirmation and discharge previously granted Medical pursuant to Chapter XI of the Bankruptcy Act.

For purposes of this appeal, the underlying facts are simple and undisputed. Pursuant to an agreement dated February 12, 1974 ("Agreement") which was approved by the Bankruptcy Court, MetPath purchased from Medical certain customer lists. It is undisputed that MetPath paid to Medical all amounts it was obligated to pay under the Agreement -- an aggregate of approximately \$500,000. On May 2, 1974, the Bankruptcy Court confirmed a Plan of Arrangement of Medical under Chapter XI of the Bankruptcy Act ("Plan") (A-20-A-26).\*

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\* Unless otherwise noted, all numbers in parentheses refer to pages of the joint appendix.

after the Court's confirmation of the Plan -- Medical, by way of petition and motion, commenced a proceeding to set aside the confirmation, revoke the approval of the Agreement, rescind the Agreement and direct the sale of the customer list for the benefit of creditors (A-5-A-10).<sup>\*</sup> On April 3, 1975, MetPath moved to dismiss Medical's petition on the ground that the proceeding was barred by 11 U.S.C. §786. By order entered May 16, 1975, Judge Ryan granted MetPath's motion and dismissed the petition. Thereupon, Medical appealed to the District Court. On December 1, 1975, the decision of the Bankruptcy Court was affirmed, the District Court holding that, "since the clear policy underlying Section 786 is the prompt and final disposition of bankruptcy matters, the six months' limitation in Section 786 is a mandatory one, which deprives the court of any discretion to entertain tardy petitions for relief [citations omitted]" (A-59).

As will be fully set forth below, the Bankruptcy Court and the District Court correctly construed the applicable law and, accordingly, the order appealed from should be, in all respects, affirmed.

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<sup>\*</sup> Medical, the debtor and party to the Plan, is the only party which expressed a dissatisfaction with the confirmation granted by the Bankruptcy Court. The Creditors' Committee neither joined in the petition nor otherwise sought judicial intervention.

## ARGUMENT

### POINT I

MEDICAL'S ATTEMPT TO SET ASIDE THE BANKRUPTCY COURT'S CONFIRMATION OF THE PLAN IS BARRED BY THE EXPRESS AND UNAMBIGUOUS JURISDICTIONAL LIMITATION OF 11 U.S.C. §786

Appellant's attempt to set aside the Bankruptcy Court's confirmation of the Plan is patently contrary to the express terms of 11 U.S.C. §786, which divests the Bankruptcy Court of jurisdiction to set aside a confirmation upon the expiration of six months. The statute provides that:

"If, upon the application of parties in interest filed at any time within six months after an arrangement has been confirmed, it shall be made to appear that fraud was practiced in the procuring of such arrangement and that knowledge of such fraud has come to the petitioners since the confirmation of such arrangement -

(1) if the debtor has been guilty or has participated in the fraud or has had knowledge thereof before the confirmation and has failed to inform the court of the fraud, the court may set aside the confirmation and thereupon, (a) where the petition was filed under section 721 of this title, reinstate the pending bankruptcy proceeding, adjudge the debtor a bankrupt, if he has not already been so adjudged, and direct that the bankruptcy proceeding be proceeded with, or (b) where the petition was filed under section 722 of this title, reinstate the proceeding, adjudge the debtor a bankrupt, and direct that bank-

ruptcy be proceeded with pursuant to the provisions of this title; or

(2) the court may set aside the confirmation, reinstate the proceeding under the petition filed under this chapter, and hear and determine applications for leave to propose, within such time as the court may fix, alterations or modifications of the arrangement for the purpose of correcting the fraud; or

(3) the court may reinstate the proceeding under the petition filed under this chapter and modify or alter the arrangement for the purpose of correcting the fraud, but may not materially modify or alter the arrangement adversely to the interests of any party who did not participate in the fraud and who does not consent to such modification or alteration, or to the prejudice of any innocent person, who, for value, subsequent to the confirmation, acquired rights in reliance upon it." (emphasis added)

In accordance with the jurisdictional limitation of 11 U.S.C. §786,\* Judge Ryan granted MetPath's motion, and dismissed Medical's petition. The dismissal of the petition was affirmed by the District Court. The decisions below are amply supported by all authorities which have construed the statute.

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\* The marginal annotation to 11 U.S.C. §786 in the United States Statutes at Large states:

"Arrangements, when set aside or modified.

"Fraud in procuring, powers of court."

Collier, in his famous treatise on Bankruptcy, states that

"An application under §386 [11 U.S.C. §786... must be 'filed at any time within six months after an arrangement has been confirmed.' The making of the motion within the six months' period is an essential prerequisite. A motion made after the six months' period cannot be granted. The court has no power to extend the time within which the motion may be made... The period of six months runs from the time the 'arrangement has been confirmed,' which means the date of the entry of the order of confirmation; it does not run from the date of the discovery of the fraud." Collier on Bankruptcy, 14th ed., ¶11.02[2], p. 648. [emphasis added].

Medical has asserted that Collier has erroneously interpreted the statute and, in support of this contention, notes that the cases cited by Collier were all decided prior to the dictum of the Supreme Court of the United States in Holmberg v. Armbrrecht, 327 U.S. 392, (1946). Holmberg and its progeny - including every case cited by Medical - dealt with statutes which imposed limitations upon a party's cause of action. In sharp contrast, 11 U.S.C. §786 does not address itself to a party's right to relief, but rather to the Court's inherent power to entertain a petition for certain specific and drastic relief. Furthermore, at least one of the cases cited by Collier has since been affirmed by the Fifth Circuit.

Solove v. Chase Manhattan Bank, 388 F.2d 874 (5th Cir. 1968), was a proceeding to revoke a discharge in bankruptcy, pursuant to Section 15 of the Bankruptcy Act,\* on the ground of fraud, where the allegation of fraud was not raised until more than one year after the discharge. In affirming the bankruptcy referee's dismissal of the petition, the Court of Appeals stated:

"The Supreme Court, in Katchen v. Landy, 1966, 382 U.S. 323, 328-329, 86 S.Ct. 467, 472, 15 L.Ed.2d 391, spelled out the function of bankruptcy legislation:

[T]his court has long recognized that a chief purpose of the bankruptcy laws is 'to secure a prompt and effectual administration and settlement of the estate of all bankrupts within a limited period.' Ex Parte Christy, 3 How. 292, 312, 11 L.Ed. 603. (Emphasis added.)

In bankruptcy disputes, 'effective and expeditious disposition' is 'remarkably important' to both litigants and the public. California Airmotive Corp. v. Bass, 9 Cir. 1965, 354 F.2d 453, 455; Kheel v. Bethlehem Steel Co., 9 Cir. 1965, 355 F.2d 187. '[I]f the bankruptcy law is to effectively serve its dual purpose of protecting both debtor and creditors \* \* there must come a time when

\* Section 15, as then enacted, read as follows:

"§15. Discharges, When Revoked. The court may, upon the application of parties in interest who have not been guilty of undue laches, filed at any time within one year after a discharge shall have been granted, revoke it if it shall be made to appear that it was obtained through the fraud of the bankrupt, that the knowledge of the fraud has come to the petitioners since the granting of the discharge and that the actual facts did not warrant the discharge."

a discharge in bankruptcy is irrevocably a discharge.' In re Early, E.D. Pa. 1940, 34 F.Supp. 774, 776." 388 F.2d 874, at 876 [All emphasis in original]

The Court went on to observe

"... in view of the many cases suggesting liberal application of statutes of limitations, that we find section 15 less concerned with notice - a traditional concern of statutes of limitations - and more concerned with finality of adjudication." 388 F.2d, at 877, fn. 4.

In addition, the Solove Court cited, with approval, the approach taken in In re Howard, 201 F. 577 (N.D. W. Va. 1913), with respect to attempts to revoke a discharge.

"It will be perceived that to revoke a discharge in bankruptcy involves an exercise of judicial discretion and power far more reaching in effect than the suspension for fraud of a statute of limitation barring the recovery of a debt or single demand of a single creditor; further, that it is in direct opposition to the whole spirit and intent of the bankruptcy act. That purpose and intent clearly is to give the bankrupt's creditors his property and to him complete relief from further claims upon him so that he may start over again. \* \* \* To revoke his discharge not alone effects his interest but also all these new obligations that he has incurred to others upon the security and strength of such discharge. \* \* \* The

limitation here is directly upon the court's power, not upon 'the cause of action'. \* \* \* To allow these petitioners under the guise of amendment to file new and possibly sufficient, possibly insufficient, petitions would be exercising judicial power on my part after, by express enactment, my right to exercise such power had ceased." 388 F.2d, at 877. [emphasis added]

The foregoing is also supported by Remington, another acknowledged authority in this area, who has observed that

"The time to apply for setting aside or modification of the arrangement under §386 [11 U.S.C. §786] is specifically limited to six months after confirmation of such arrangement." Remington on Bankruptcy, Vol. 9, §3678, p. 358 (6th edition).

In re Graco, Inc., 267 F. Supp. 952 (D. Conn. 1967), sets forth an incisive analysis of the rationale underlying the inflexibility of this rule:

"It may be argued that the power of the referee or court to reconsider and disallow previously allowed claims implies a power to reopen the creditors' meeting and take another vote upon the arrangement. Although not totally without logic, this position does violence to any principle of finality in bankruptcy proceedings. Though the act provides for reconsideration and disallowance of previously allowed claims, the act also provides in §386 the exclusive means of setting aside an order of confirma-

tion. In order to come within the provisions of this section, a showing of fraud must be made within six months of confirmation. No such showing was made here and the time limitation has expired.

\* \* \*

Once the [creditors] meeting concludes, the vote taken there, absent fraud, is binding at all later stages of the proceeding, regardless of later allowance or disallowance of claims. In *re Chinese Fur Importers, Inc.*, supra, 269 F. 669. To hold otherwise would render the procedure of a Chapter XI arrangement, already cumbersome, substantially more unwieldy by destroying the inherent sense of finality that the conclusion of a creditors' meeting and subsequent order of confirmation now brings." 267 F. Supp. at 955-956.

In fact, the courts have gone so far as to state that a referee has no power to extend this six months' limitation, even under circumstances where the referee may have induced the creditor's attorney to refrain from filing his petition in time. Matter of Crusader Oil Refining Corp., 47 F. Supp. 873 (D. N.J. 1942).

In re Leight & Co., 139 F.2d 313 (7th Cir. 1943), dealt with §13 of the Bankruptcy Act (the predecessor to 11 U.S.C. §786). The Court of Appeals there held that

"where a composition had been confirmed and launched in accordance with its terms, and all claims of the creditors had been

either allowed or disallowed, and where the bankruptcy court had disposed of all administrative matters in connection with the proceedings, and six months had elapsed from the date the composition was confirmed, the bankruptcy court's jurisdiction over that proceeding was ended. The purpose of such compositions is to avoid administration in bankruptcy and to free the property from the jurisdiction of the bankruptcy court; in other words, to bring the affairs of bankrupts or debtors to a speedy and conclusive termination. [citing cases]" 139 F.2d at 315.

See also Whiteford Plastics Co. v. Chase National Bank, 179 F.2d 582 (2d Cir. 1950), where this Court stated that a confirmed plan of arrangement is "binding on all parties in the absence of fraud and under Section 386 of Chapter XI, 11 U.S.C.A. §786, the arrangement could only be attacked for fraud and within six months after confirmation." Id. at 584. To the same effect, see In re Mirkus, 289 F. 732 (2d Cir. 1923), ("It is undoubted that a discharge loses none of its efficacy if, after the time for revocation thereof has passed (section 15 [Comp. St. §9599]), fraud is discovered which would have barred the discharge if found out in time, or that a composition loses its value if after the time for setting it aside has passed (section 13 [Comp. St. §9597]) fraud is discovered;...") Id. at 735.

Medical's attempt to reinstate its tardy and time-barred petition is buttressed by a recitation of a plethora

of cases which fail to lend any support whatsoever to Medical's position. Indeed, not a single case cited by Medical in its brief deals with the statute at bar, and every one of those cases ruled upon a statute of limitations fundamentally different than the jurisdictional bar of 11 U.S.C. §786.

In every case cited by appellant, the Court was confronted with (1) a statute of limitations which made no specific provision for the time an alleged fraud had to be discovered in order to "start the clock," and (2) an alleged perpetrator of a fraud who, by successfully invoking the statute of limitations, would leave the defrauded party entirely without a remedy. Neither element is present here.

The statute at issue specifically provides that an application to set aside a confirmation must be "filed... within six months after an arrangement has been confirmed" and then only on the grounds of fraud if "knowledge of such fraud has come to the petitioners since the confirmation of such arrangement..." (Emphasis added). Thus, the plain language of the statute negatives any possibility that the time within which a petition must be filed begins to run

when a petitioner discovered or should have discovered the alleged fraud. Indeed, it is a prerequisite that he not have discovered the fraud until after the confirmation. Nonetheless, the statute provides that the "clock begins to run" on the date of confirmation.

Therefore, it must be seen that, upon the expiration of six months from the date of confirmation, the Bankruptcy Court is divested of any and all jurisdiction to reopen the bankruptcy or set aside and revoke the confirmation of the Plan. Medical's authorities are not to the contrary.

## POINT II

THE CONSTRUCTION GIVEN TO 11 U.S.C. §786 BY THE FEDERAL COURTS HAS BEEN APPROVED BY CONGRESS AND IS BINDING ON THIS COURT

As Point I, supra, demonstrates, since at least as early as the 1923 decision in In re Mirkus, supra, and throughout the period following Holmberg vs. Albrecht, supra (see, e.g., In re Graco, Inc., supra), the federal courts, including the District Court below, have followed the plain language of 11 U.S.C. §786 and have interpreted that statute and its' predecessors as a strict limitation on the jurisdiction of the Bankruptcy Courts, which absolutely prohibits setting aside a plan of arrangement after six months from its confirmation. As set forth below, Congress has given its approval to this longstanding judicial interpretation. Thus, this interpretation is stare decisis and the decision below must be affirmed.

11 U.S.C. §786 (§386 of the Bankruptcy Act) was originally enacted as §13 of the Bankruptcy Act of 1898 (later to become 11 U.S.C. §31), which provided:

"The judge may, upon the application of parties in interest filed at any time

within six months after a composition has been confirmed, set the same aside and reinstate the case if it shall be made to appear upon a trial that fraud was practiced in the procuring of such composition, and that the knowledge thereof has come to the petitioners since the confirmation of such composition."

The language of §13 is substantially identical to the relevant provision of §386.

After the courts in In re Mirkus, supra, and In re Rudnick, 93 F.787 (D. Mass. 1899) held §13 to be a strict limitation on the jurisdiction of a court in bankruptcy, Congress amended the Bankruptcy Act in 1933 by adding §§74(k) and 75(m) (11 U.S.C. §§202(k), 203(m)), which were substantially identical to §13 and which applied to agricultural and other types of compositions.

In 1938, Congress drastically revised the bankruptcy statute by enacting the Chandler Act. Section 13 was modified and reenacted as §386. Section 74(k) was revised in identical fashion and became §511 (11 U.S.C. §911). A new section, §671 (11 U.S.C. §1071), substantially identical to the new §§386 and 511 and applicable to wage earners, was also added. See In re Leight & Co., supra, 139 F.2d at 315, note

1. Sections 386, 511 and 671 are still in effect today. Section 75(m) was not revised and expired in 1949.

Thus, over the at least fifty-three years during which the federal courts have consistently construed the former §13 and its successors as limiting the Bankruptcy Court's jurisdiction, barring it from setting aside a plan of arrangement after six months from its confirmation, Congress has carefully considered §13, enacted two substantially identical provisions applicable to various other types of arrangements, and modified this statute without materially altering those provisions here at issue. Such action compels the conclusion that Congress has approved the longstanding judicial interpretation of §§13 and 386, and that this interpretation is consistent with congressional intent.\*

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\* Medical has quoted Dabney v. Levy, 191 F.2d 201 (2d Cir. 1951), for the proposition that:

"... in cases of 'fraud' used to include at least instances of the kind at bar, when Congress does not choose expressly to say the contrary, the period of limitation set by it only begins to run after the injured party has 'discovered, or has failed' in reasonable diligence to discover' the wrong." 191 F.2d at 205.

Here, the plain language of the statute demonstrates that, even if 11 U.S.C. §786 operated on a party's "cause of action" rather than on the inherent power of the Court, Congress has expressly chosen to say that the six month time bar is absolute and has had ample opportunity to clarify or modify the statute if its intent were other than as interpreted by the courts.

In Missouri v. Ross, 299 U.S. 72 (1936), the Supreme Court interpreted another section of the Bankruptcy Act and held as follows:

"In New Jersey v. Anderson, 203 U.S. 483, 489, 27 S.Ct. 137, 139, 51 L.Ed. 284, this court specifically said: 'The requirement of the present law is a wide departure from the act of 1867, and specifically obliges the trustee to pay all taxes legally due and owing, without distinction between the United States and the State, county, district, or municipality.' It is true that this statement was not necessary to the decision; but it nevertheless correctly states our view as to the meaning of the clause under consideration, and is now definitely approved. The decision in that case was made nearly 30 years ago, since which time the lower federal courts have almost unanimously followed the rule there stated....These decisions are plainly correct; but, if they were doubtful, we should at this late day hesitate to disturb them.... Moreover, Congress in the face of these decisions has permitted the clause as it now appears in paragraph (b) (6) to stand for many years without change in its phraseology, although amending that portion of the Bankruptcy Act in other particulars. This is persuasive evidence of the adoption by that body of the judicial construction [citation omitted]" [emphasis added] 299 U.S. at 75.

In accord, see also Bardwell v. Petty, 286 F.772 (D.C.Cir. 1923):

"That interpretation was made in 1887, and for 35 years has stood as the law...in this jurisdiction. Moreover,... the Congress... deliberately amended [this] Act [subsequently], but did not

amend away or modify in any particular the judicial interpretation given to the earlier act. ... Congress having the opportunity to meet the decision of the court in Murphy v. Preston, and having declined to do so, we must assume that that decision met with legislative approval.

Legislation once judicially, or even administratively, interpreted, if left for a long period of time unchanged, unmodified, or unamended, may well justify the conclusion that the judicial or administrative interpretation was in accord, and not at variance, with the legislative intention...

The construction given to the act... must be considered as stare decisis" 286 F.773-774.

Cf. Toolson v. New York Yankees, 346 U.S. 356, reh. den., 346 U.S. 917 (1953).

The Federal Courts have unanimously adopted the construction of §386 urged by MetPath and followed by the courts below. "Moreover, Congress in the face of these decisions has permitted the clause... to stand... although amending that portion of the Bankruptcy Act in other particulars." As was true in Missouri v. Ross "[t]his is persuasive evidence of the adoption" by Congress of the judicial construction urged by MetPath.

The construction long given to 11 U.S.C. §786 is clearly consistent with the intent of Congress and must be followed. The decisions of the Bankruptcy and District Courts upholding this interpretation must be affirmed.

POINT III

THE ACTION OF THE COURTS BELOW DID NOT  
AFFECT MEDICAL'S RIGHT TO ASSERT A CLAIM  
IN A COURT OF COMPETENT JURISDICTION FOR  
ANY INJURY IT MAY FEEL IT HAS SUFFERED AS  
A RESULT OF THE ALLEGED FRAUD

Medical urges that the interpretation advanced by MetPath - and approved both by Bankruptcy Judge Ryan and District Judge Connor in this proceeding and by the federal courts in the cases cited herein - will produce "an inequitable and unjust result." (Brief for Appellant, p. 15). Medical contends that an alleged perpetrator of a "sophisticated" fraud should not be permitted to take refuge behind the statute of limitations. There can be no reasonable dispute with this equitable principle; however, it is totally inapplicable to the instant appeal. The relief which Medical sought below was not simply a vehicle whereby it would be afforded a remedy for an alleged fraud. On the contrary, it proposed to undo a confirmed plan of arrangement, confiscate MetPath's assets and reopen an entire bankruptcy proceeding, in direct contravention of 11 U.S.C. §786.

Thus, it must be recognized that the statute at issue herein is fundamentally and materially different from every

statute cited by Medical. The rationale underlying every such authority is to insure that a defrauded party shall retain his remedy against the party who defrauded him, if he acts expeditiously upon discovering the fraud. MetPath does not seek - by the motion below or otherwise - to deprive Medical of whatever rights it might have to bring an action against any person it may feel has defrauded it. Dismissal of the petition did not affect those rights, and the action of the Bankruptcy Court, affirmed by the District Court, does not deprive Medical of a remedy for any allegedly fraudulent acts of any person. It simply confirms the well-settled principle that setting aside a confirmed plan of arrangement after the expiration of six months is not the proper remedy. The statutory limitation is upon the Bankruptcy Court's jurisdiction, not on Medical's cause of action. Such an action, if otherwise proper, is not barred as a result of the dismissal of Medical's petition, but must rise or fall on its own merits before a court of competent jurisdiction.

Medical has asserted that its financial position would render it impossible for it to maintain an action predicated upon fraud (Brief for Appellant, p. 24). While MetPath has

no way of knowing whether or not such is in fact the case, it does know that, pursuant to an agreement between Medical and MetPath dated February 12, 1974, MetPath has paid to or for the account of Medical \$499,993.00 (A-50, A-53). In return, MetPath received Medical's customer list (A-36). If Medical is in fact unable to afford litigation, it is incomprehensible how it proposes to set aside the Plan and repay MetPath the nearly half a million dollars it has paid Medical. Contrary to what Medical would represent to this Court, equity and justice do not line up so neatly on Medical's side of this dispute. However, the overriding reality remains that Medical's alleged financial difficulties cannot invest the Bankruptcy Court with jurisdiction to set aside the confirmation of the Plan. The Court was finally and irrevocably stripped of all such jurisdiction six months after the date of confirmation by the express mandate of 11 U.S.C. §786. Medical is in the wrong court.

CONCLUSION

By reason of the foregoing, the conclusion is inescapable that, in accordance with the mandate of 11 U.S.C. §786, the Bankruptcy Court possesses no jurisdiction to entertain Medical's petition. Accordingly, the order appealed from must be, in all respects, affirmed.

Respectfully submitted,

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A 202 Affidavit of Personal Service of Papers  
UNITED STATES COURT OF APPEALS  
FOR THE SECOND D CIRCUIT

LUTZ APPELLATE PRINTERS, INC.

IN THE MATTER OF

MEDICAL ANALYTICS,

- ~~Plaintiff~~ -  
Debtor,

Index No.

Affidavit of Personal Service

STATE OF NEW YORK, COUNTY OF NEW YORK ss.:

I, Reuben A. Shearer being duly sworn,  
depose and say that deponent is not a party to the action, is over 18 years of age and resides at  
211 West 144th Street, New York, New York 10030  
That on the 30th day of March 19 76 at 555 Madison Avenue New York, New York  
deponent served the annexed Appellee 's Brief upon

Lans Feinberg & Cohen

the Attorneys in this action by delivering a true copy thereof to said individual  
personally. Deponent knew the person so served to be the person mentioned and described in said  
papers as the herein,

Sworn to before me, this 30th  
day of March 19 76

*Robert T. Brin*

*Reuben Shearer*  
Reuben Shearer

ROBERT T. BRIN  
NOTARY PUBLIC, State of New York  
No. 31-0418950  
Qualified in New York County  
Commission Expires March 30, 1977